

1 UNITED STATES DISTRICT COURT

2 DISTRICT OF MASSACHUSETTS

3 No. 1:15-cv-14128-WGY

4  
5 JAMES ELLIS, et al,  
6 Plaintiffs

7 vs.

8  
9 FIDELITY MANAGEMENT TRUST COMPANY,  
10 Defendant

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12  
13 For Hearing Before:  
14 Judge William G. Young  
At Suffolk University Law School

15  
16 Summary Judgment

17 United States District Court  
18 District of Massachusetts (Boston)  
19 One Courthouse Way  
Boston, Massachusetts 02210  
Thursday, April 6, 2017

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22 REPORTER: RICHARD H. ROMANOW, RPR  
23 Official Court Reporter  
24 United States District Court  
One Courthouse Way, Room 5510, Boston, MA 02210  
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1 P R O C E E D I N G S

2 (Begins, 2:20 p.m.)

3 THE CLERK: Ellis vs. Fidelity Management.

4 THE COURT: Would counsel introduce  
5 themselves.

6 MR. JACOB: Gregory Jacob for the defendant,  
7 Fidelity Management Trust Company.

8 MR. FALVEY: Also John Falvey, Goodwin  
9 Procter, for Fidelity.

10 MR. KIM: Good afternoon, your Honor, Jason  
11 Kim on behalf of the plaintiffs, on the plaintiff class  
12 that's been certified.

13 MR. GORDON: Jeff Gordon on behalf of the  
14 plaintiffs.

15 THE COURT: All right.

16 This is the defendant's motion for summary  
17 judgment and I'll hear you.

18 MR. JACOB: Thank you, your Honor.

19 Plaintiffs' sole claim is that Fidelity breached  
20 its fiduciary duties by managing the Managed Income  
21 Portfolio, or "MIP," a safe investment option with a  
22 fully-disclosed investment strategy in a way that was  
23 too safe. Let me say that again. 401K funds are --

24 THE COURT: I've read your briefs, you say it  
25 there, you've now said it a second time, and you want to

1 say it a third. But you argue. Go ahead.

2 MR. JACOB: Your Honor, MIP is that same  
3 option that every 401K plan's required to have for  
4 retirees and older investors, that they can use it as a  
5 safe harbor in stormy markets to protect their  
6 retirement.

7 THE COURT: Isn't the nub of your argument  
8 that even -- this is summary judgment so I have to take  
9 everything their way. If I take all their submissions  
10 their way and draw the reasonable inferences their way,  
11 this is insufficient to the evidence, there is not  
12 sufficient evidence that Fidelity breached its duty of  
13 prudence or loyalty.

14 MR. JACOB: That's absolutely correct, your  
15 Honor, there's no evidence at all to support their  
16 loyalty claim or their prudence claim.

17 With respect to their prudence claim, your Honor,  
18 they alleged Fidelity's safe strategy breached that duty  
19 of prudence, that is as of January 1st, 2010, the  
20 beginning of the class period, prudence required  
21 Fidelity to make riskier investments. This Court's  
22 decision in **Bunch** provides the framework for deciding  
23 that claim.

24 **Bunch** establishes two key principles for  
25 evaluating it. First, the Court should look at the

1 defendant's conduct to determine whether it used a  
2 prudent process, and second, plaintiffs are not allowed  
3 to second guess Fidelity's decisions reached through a  
4 prudent process and judge them in hindsight based on  
5 results.

6 Now, **Bunch's** hindsight prohibition means that  
7 plaintiffs' prudence claim must be judged from January  
8 1st, 2010, two years into the financial crisis, with no  
9 knowledge of how future markets are going to perform.  
10 What injunction, your Honor, are plaintiffs saying that  
11 as of that day, knowing what was known then, that this  
12 Court should have entered?

13 Had the Court read plaintiffs' expert report, the  
14 Court would think that the injunction was more  
15 securitized mortgages, the very instrument that caused  
16 the whole financial crisis, and, by the way, the very  
17 same lawyers have sued JP Morgan for doing exactly that,  
18 but Fidelity had robust process on MIP's mortgage  
19 allocation and they have essentially abandoned this  
20 argument in their summary judgment opposition because  
21 the whole premise is so obviously ridiculous.

22 In their briefs plaintiffs say that MIP's  
23 benchmark is a rare and unusually conservative  
24 benchmark, so perhaps the injunction would be "use some  
25 other benchmark," but that theory can't survive **Bunch**

1     either. Plaintiffs don't dispute that Fidelity had  
2     robust process on MIP's benchmark, they don't dispute  
3     they didn't examine alternatives, they didn't perform  
4     quantitative analyses, they didn't look at risk-reward  
5     tradeoffs, that's the undisputed record, and that's  
6     exactly what **Bunch** says that a prudent fiduciary does,  
7     it considers all those factors and comes to a considered  
8     judgment. Plaintiffs disagreed with Fidelity's decision  
9     to retain that benchmark, but **Bunch** does not allow them  
10    to get to a trial on that basis. And it's pure  
11    hindsight for them to say that some other benchmark,  
12    which they don't specify, would have yielded higher  
13    returns. And, by the way, your Honor, if you look at  
14    Paragraph 49 of plaintiffs' complaint, you'll see that  
15    this benchmark, which they say was "rare and unusually  
16    conservative," was actually commonly used by the stable  
17    value industry following the financial crisis.

18           Plaintiffs' final process argument is that  
19    Fidelity did nothing to improve its performance until  
20    2015. Here I suppose the injunction, if such an  
21    injunction were permissible, would be "Do something."  
22    But the record is filled with Fidelity doing something,  
23    it did exactly what **Bunch** said it was supposed to do, it  
24    looked at the alternatives, it weighed the risk-reward  
25    tradeoffs, and it came to decisions. That is **Bunch's**

1 very definition of a "prudent process." There are no  
2 disputed facts on that point. And it's pure hindsight  
3 for plaintiffs to now come in and say, "Well, we  
4 disagree," when Fidelity, after a thorough analysis,  
5 decided to stay in a more conservative direction.

6 Moreover there's lots of evidence in the record  
7 that Fidelity didn't always decide to stay in a more  
8 conservative direction, but rather at points added risk.  
9 Their expert admits that every year, beginning in 2010,  
10 Fidelity added risk into the portfolios. The fact  
11 sheets that are in the record before the Court show  
12 there are significant shifts in investment allocations  
13 during that period of time. And it's undisputed that  
14 MIP's returns improved every year of the class period.

15 Now plaintiffs are going to come up and they're  
16 going to say, "Well, your Honor, ignore all that process  
17 because that's not the decision we're challenging," what  
18 we're saying is Fidelity shouldn't have been so  
19 conservative, but when the Court hears that it needs to  
20 realize that all within that record of a prudence  
21 process was weighing risk-reward tradeoffs everyday,  
22 "Should we be more risky?" "Should we be more  
23 conservative?" There's tens of thousands of pages of  
24 Fidelity making that decision in that record. And they  
25 can't sidestep **Bunch** just by being vague and saying,

1 "Well, it was some decision that we're not going to  
2 specify when it was made and therefore all the process  
3 that Fidelity conducted is irrelevant." Fidelity is  
4 entitled to judgment on that claim.

5 THE COURT: Thank you.

6 MR. JACOB: Now with respect to the loyalty  
7 claim, your Honor, plaintiffs invented this new and  
8 unpleaded conflict theory in their summary judgment  
9 opposition realizing that they had no prudence claim and  
10 let me summarize their argument.

11 It's undisputed that --

12 THE COURT: Briefly. Go ahead.

13 MR. JACOB: It's undisputed that every stable  
14 value fund needs insurance coverage called wrap  
15 contracts and plaintiffs argue that Fidelity  
16 deliberately sabotaged its clients by agreeing to bad  
17 contract terms so that it could get extra insurance  
18 coverage for new clients. Well, to begin with, your  
19 Honor, that whole theory is just kooky. What investment  
20 manager sabotages its current clients and drives down  
21 its performance in order to attract new clients? And as  
22 might be expected of a theory that just makes no sense,  
23 there's no evidence to support it.

24 All that they point to, all that they have in this  
25 record is evidence that Fidelity wanted to grow its



1 business. Of course it did. Every investment manager  
2 wants to do that. That doesn't get them to a trial.  
3 What the First Circuit's decision in **Vander Luitgaren**  
4 says they have to show in order to make out a loyalty  
5 claim is that Fidelity took some action that harmed MIP  
6 in pursuit of its own interests, and they have nothing  
7 on that front.

8 Yes, Fidelity did negotiate more conservative  
9 contracts in 2009 in order to get wrap coverage, but it  
10 is undisputed in the record that MIP needed that  
11 coverage between 2008 and 2009 when up to 60 percent of  
12 its wrap coverage was in danger. There is zero evidence  
13 that Fidelity could have secured that wrap coverage on  
14 better terms, their own expert admits that the terms  
15 that we got it on were perfectly prudent. The one  
16 contract that plaintiffs actually attack was negotiated  
17 in 2009 and there was zero evidence that any of the  
18 coverage Fidelity got went to some new client. There's  
19 no evidence and Fidelity's entitled to judgment on the  
20 claim.

21 THE COURT: Thank you.

22 Mr. Kim.

23 MR. KIM: Thank you, your Honor.

24 So I wanted to start by saying what our case was  
25 and what it's not about, um, and this is right in the

1 complaint. If you look at Paragraph 2, the theme of our  
2 complaint was that Fidelity, um, imposed an excessively-  
3 conservative approach in order to favor the interests of  
4 wrap providers over the investors. I can site to many  
5 other paragraphs in the complaint where we make the same  
6 point. Obviously we did not have the level of detail  
7 that we have now, but the core theory has been the same  
8 from start to finish.

9 But turning to, um --

10 THE COURT: How does that make sense?

11 MR. KIM: Sure, your Honor. And, you know,  
12 this actually is a really good point about why this case  
13 requires some fairly nuanced factfinding. So let me  
14 explain to you how this makes sense.

15 One, is Fidelity has admitted that a lot of the  
16 plan sponsors don't understand this product very well.  
17 Second, as Fidelity has also admitted, that because it  
18 serves as a record keeper, so that is the person who  
19 does the administrative work for the funds that offer  
20 the stable value fund, there's a certain amount of  
21 stickiness, it's not easy to change. So if you're a  
22 plan sponsor and assuming you're sophisticated enough  
23 that you understand that you are getting a very subpar  
24 product, you would not necessarily be in a position to  
25 change right away. And so I think it's a rational

1 tradeoff from Fidelity's point of view to say that, um,  
2 "We can get away with some subpar performance and what's  
3 more important to us than ensuring that the investors  
4 get the best possible return is to make the wrap  
5 providers happy, because they like us more than they  
6 like our competitors, and we'll be first in line to get  
7 wrap capacity, and that will allow us to start taking  
8 business away from those competitors and being in a  
9 position to grow the business." So that is how it makes  
10 sense, your Honor.

11 And I realized --

12 THE COURT: I'm sorry, but to do that your  
13 theory is that you're going to have poor performance?  
14 That just flies in the face of logic, it seems to me.

15 MR. KIM: Your Honor, yes, as I explained, and  
16 I think we put some -- we went to great pains to explain  
17 the background of this in our opposition. The normal  
18 competitive pressures of an investment product are  
19 somewhat muted in this case for the reasons I expressed  
20 before.

21 THE COURT: And I can see that, but "somewhat  
22 muted" doesn't extinguish them.

23 MR. KIM: It doesn't extinguish it, your  
24 Honor, but I know you realize -- you're thinking it's  
25 counterintuitive, but let me just point out a few things

1 on the record here about the performance and along the  
2 lines of the logic that you're setting out, "Well, why  
3 didn't someone do something about this, why didn't  
4 people start leaving this product en mass?" And if you  
5 look at Exhibit AO, which is an e-mail, what they say is  
6 that the performance was in the bottom decile, that is  
7 the bottom 10 percent. That's pretty bad. I think we  
8 would all give that an "F" grade. Fidelity's a very  
9 fine company and I think we'd expect quite a bit more  
10 from that.

11 Exhibit U -- I'm sorry, Exhibit BE, a consultant  
12 points out that they're tracking about 30 stable value  
13 funds and this performance is about at the bottom of  
14 that. And if you look at Exhibit U, this is an internal  
15 document where they're discussing -- they're  
16 memorializing sort of the internal discussions amongst  
17 the portfolio managers, they note in that brief document  
18 three times, um, that their rates are uncompetitive and  
19 they also note that the range of stable value fund  
20 returns that they're aware of are 1.80 to 4.30 and we're  
21 at 1.80. So that's just a part of the evidence that  
22 we've put in about the poor performance. So I don't  
23 think it can be denied that there was very notably poor  
24 performance and Fidelity itself noted that.

25 So the question then is "Why was there poor

1 performance, was the poor performance simply that they  
2 didn't know what they were doing or was the poor  
3 performance the result of strategic decisions that they  
4 made for reasons other than trying to obtain the best  
5 crediting rate for the investors?" And we've put in  
6 quite a bit of evidence suggesting, um, with respect to  
7 this wrap capacity, um -- and I will refer you to  
8 Exhibit AK, they describe that as a "Priority Number 1,  
9 obtaining wrap capacity," their words, not our words.  
10 One would think that your Priority Number 1 would be  
11 achieving a good return for your investors, but they  
12 were more interested in wrapping up and obtaining more  
13 wrap capacity.

14 And, you know, I know what they're saying here, is  
15 that wrap capacity was necessary to continue to operate  
16 the fund, but that doesn't -- that's not the rationale  
17 that's provided in the documents. And if you look at  
18 Exhibit F, they talk about their goal is to obtain  
19 significantly more wrap capacity than competitors. And  
20 if you look at Exhibit O, um, they admit that what they  
21 did is they accepted the more conservative guidelines in  
22 exchange for getting more wrap capacity from wrap  
23 providers.

24 So if you look at an overall pattern of conduct  
25 and if you look at the documents -- and not only what

1 the documents say, but what they don't say, what they  
2 don't say is "We're seeking the wrap capacity in order  
3 to better serve our existing investors."

4 THE COURT: Let me challenge you with the  
5 defendant's question.

6 MR. KIM: Sure.

7 THE COURT: What is it -- and again it will be  
8 in hindsight, but what is it, if we got to a trial here  
9 and I was going to make an order, what order would you  
10 have me impose upon them?

11 MR. KIM: Sure, your Honor, and that's a good  
12 question, it does go to what the case is about. I mean  
13 obviously our intent would be for an order finding that  
14 there was a breach of a fiduciary duty. But in terms of  
15 forward-looking relief --

16 THE COURT: And -- yes.

17 MR. KIM: In terms of forward-looking relief,  
18 what I would say is that no one denies the fact that as  
19 of right now they did make changes, and we put a lot of  
20 material in there about this brand new business planning  
21 process in 2015 as an acknowledgement that their  
22 existing processes were suboptimal. They devoted some  
23 effort to a firm-wide business planning process. And  
24 they noted as a result that their performance is  
25 converging, and as far as I know to this day, right now

1 in 2017, they're performing about as well as an average  
2 stable value fund. But what we're concerned with is in  
3 2010 through the present. So the fact that it may have  
4 been cured to some extent now doesn't negate the rest of  
5 the claim. So I don't know --

6 THE COURT: Well, what would -- go back to  
7 2010, what would I order?

8 MR. KIM: Well, your Honor, I mean 2010  
9 already happened, so you would order -- you would find  
10 that there was a breach of fiduciary duty.

11 THE COURT: No, but suppose that's the way he  
12 --

13 MR. KIM: Oh, back in 2010 what you would have  
14 ordered?

15 THE COURT: Right.

16 MR. KIM: So had you been aware of all of the  
17 circumstances that we've put in front of you where they  
18 said that their business plan involved "favoring  
19 interests of wrap providers versus the investors," you  
20 would say "You need" -- like in **Bunch**, "You need perhaps  
21 -- because it seems like your investment decisions are  
22 infected by your desire to grow the business, you should  
23 look into obtaining the services of an independent  
24 fiduciary in 2010" --

25 THE COURT: I see. All right.

1                   MR. KIM: -- "to make sure that your decisions  
2                   are really in the best interests of the investors and  
3                   not your interests as a business."

4                   THE COURT: Thank you. I'll take the matter  
5                   under advisement.

6                   (Ends, 2:40 p.m.)  
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C E R T I F I C A T E

I, RICHARD H. ROMANOW, OFFICIAL COURT REPORTER,  
do hereby certify that the foregoing record is a true  
and accurate transcription of my stenographic notes  
before Judge William G. Young, on Thursday, April 6,  
2017, to the best of my skill and ability.

/s/ Richard H. Romanow 08-03-17  
\_\_\_\_\_  
RICHARD H. ROMANOW      Date